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RÉPUBLIQUE FRANÇAISE

2019

*Europe - U.S. Symposium on Building  
the Financial System of the 21<sup>st</sup>  
Century*





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## **Threats to Cross-Border Banking: Resolution and Brexit**

- Cross-border resolution – global dimensions
  - Ringfencing has become the global norm
    - Subsidiarization, internal TLAC
    - Is SPOE effectively dead?
  - Lack of legal clarity - definitions, functions, regulation of branches vs. subs
  - Coordination in case of actual resolution
    - Trust and ringfencing – “trust” and coordination are easier when the cash is in place (TLAC, MREL, etc)
  - Lingering questions:
    - Is fragmentation reasonable price to pay to protect taxpayers?
    - Fed’s toolbox to stop contagion limited by Dodd-Frank
    - Is banking more or less fragile in this new world?



## Threats to Cross-Border Banking: Resolution and Brexit

- Cross-border resolution – Europe
  - Even within EU, cross-border resolution is challenging
  - Italy examples: bail-out rather than bail-in
  - Gaps persist among ESRB, EC, and national authorities
    - EU resolution directive superimposed on varied national bankruptcy laws
    - Actual bank failures follow political, not just legal, logic
  - SRF still not fully funded
  - Basic problem: EU is trying to solve political problems through regulation, but outcomes ultimately depend on social impact



## Threats to Cross-Border Banking: Resolution and Brexit

- Brexit and “enhanced equivalence”
  - Is this a promise or a threat?
    - UK may face higher information and legal requirements, extraterritorial supervision
    - Implications for US?
  - Opening the black box of equivalence
    - Reducing UK uncertainty of future – reciprocity? procedural transparency?
    - Is there a multilateral solution to the web of bilateral agreements?
  - Equivalence should be outcomes-based, non-politicized
    - Should not require submission to extraterritorial supervision
  - Goals of actors differ
    - EU: accommodating Brexit is secondary to CMU, SRF; seeking competitive advantage
    - UK: bank branches in EU limited, so main concern is markets and CCPs



## Threats to Cross-Border Banking: Resolution and Brexit

- Fragmentation as the new normal in Europe
  - Limited European financial market so far, despite CMU dreams
    - Fragmentation results from regulation, supervisory practices, politics
  - MiFID II effects – liquidity pools, localization of CCPs, etc
  - Effects of fragmentation
    - Liquidity down, costs up
    - May be price of being global for banks, but damaging to asset managers
    - Does not improve resolvability
  - Politics of fragmentation
    - Are European countries looking again to national champions?
    - Is Brexit just one example of populist-driven fragmentation?



## The Evolution of the Asset Management Industry

- Changing face of asset management
  - Key question for regulators and industry: how well are end-investors being served?
  - Competition and tech
    - Changing trading and allocation strategies
    - Driving down costs for investors
  - Changing balance of active and index funds
    - Debate on impact of index investing on liquidity, price determination
    - Retail distributors shifting from selling funds to selling portfolio allocation



## The Evolution of the Asset Management Industry

- EU asset management
  - Market liquidity and efficiency lag US
  - EU regulators still see asset managers as big, bank-like SIFIs
    - But end-users actually own shares, not funds, & mutual funds not leveraged
    - Lingering suspicions of foreign asset managers, preference for domestic
    - Is ECB the right regulator?
  - Structural challenges
    - Lack of private pension funds retards both growth of asset management sector and feasibility of CMU
    - Lack of culture/tradition of risk capital in much of Europe
  - Effects on allocation of capital, economic growth



## The Evolution of the Asset Management Industry

- Composition of indexes
  - Bespoke “indexes” subvert the whole point
    - Not really indexes
    - Grading on their own curve
  - Is there a role for government?
    - Standard setting, transparency, “taxonomies”
    - May be a slippery slope!
  - Potential benefits of competition among indexes and index funds
- Benchmarks and the EU
  - Desire to protect investors (lessons of LIBOR)
  - Increasingly assertive regulation
    - What are pros and cons?
    - Extraterritoriality: will EU regulate the entire extended family of IBORs? How?





## The Evolution of the Asset Management Industry

- ESG and asset management
  - Europe is asking asset management to solve societal issues
    - Comprehensive strategy or just shifting responsibility?
    - Should bear in mind that regulation of asset management means regulation of household assets
  - ESMA is building ESG agenda
    - Taxonomy of green companies
    - Will it go beyond mandated disclosure (e.g., risk-weighting of bonds)?
    - How to integrate with benchmarking rules?
  - How will Europe's ESG agenda affect the world
    - Global leader?
    - Effects on US firms?



## The Evolution of the Asset Management Industry

- US approach is still private, voluntary
  - Private standard-setting bodies
    - E.g. Sustainability Accounting Standards Board
  - Market-driven
    - Disclosure remains voluntary (but will this change under President Warren?)
  - Very different political status of sustainability from EU
- ESG and risk
  - Increasing sense that ESG aligns with long-term profitability
  - How to measure ESG commitment and impact?
    - Need better, more standardized data – who will provide?
    - What are the necessary tools and models?



# UPCOMING EVENTS

2019

## China - U.S. Symposium

*June 5 – 7, Washington, D. C.*

## Japan - U.S. Symposium

*October 4 – 6, Odawara, Japan*

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